STATE OF HAWAII—DEPARTMENT OF TAXATION

INSTRUCTIONS FOR FORM N-340
MOTION PICTURE, DIGITAL MEDIA, AND FILM PRODUCTION INCOME TAX CREDIT

CHANGES TO NOTE FOR 2006

Pursuant to Act 88, Session Laws of Hawaii 2006, effective July 1, 2006, the Motion Picture and Film Production Income Tax Credit is replaced with the Motion Picture, Digital Media, and Film Production Income Tax Credit for the period of July 1, 2006 to December 31, 2015. On January 1, 2016, the Motion Picture, Digital Media, and Film Production Income Tax Credit will be repealed and the Motion Picture and Film Production Income Tax Credit will be reinstated.

Presently, the Motion Picture and Film Production Income Tax Credit can be claimed only for production and transient accommodations costs incurred in the taxable year before July 1, 2006.

GENERAL INSTRUCTIONS

Note: If you are claiming the Ethanol Facility Tax Credit, no other credit can be claimed for the same taxable year.

Effective July 1, 2006, each taxpayer subject to Hawaii's net income tax, who incurs qualified production costs in Hawaii after June 30, 2006, and before January 1, 2016, related to a qualified production, may claim a refundable motion picture, digital media, and film production income tax credit for the taxable year in which the credit is properly claimed. The amount of the credit is:

1. 15% of the qualified production costs incurred by a qualified production in any county of the State with a population of over 700,000; and
2. 20% of the qualified production costs incurred by a qualified production in any county of the State with a population of 700,000 or less.

A qualified production occurring in more than one county may prorate its expenditures based upon the amounts spent in each county, if the population bases differ enough to change the percentage of tax credit. The total tax credits claimed per qualified production cannot exceed $8,000,000.

With regard to the credit for qualified production costs, three special provisions apply:

1. If a deduction is taken under Internal Revenue Code (IRC) section 179 (with respect to an election to expense depreciable business assets), no tax credit shall be allowed for those qualified production costs incurred after June 30, 2006, and before January 1, 2016, for which the IRC section 179 deduction was taken;
2. The basis of eligible property for depreciation or accelerated cost recovery system (ACRS) purposes for State income taxes shall be reduced by the part of the tax credit related to qualified production costs incurred after June 30, 2006, and before January 1, 2016, that is allowable and claimed; and
3. After June 30, 2006, and before January 1, 2016, no qualified production cost that has been financed by investments for which a credit was claimed by any taxpayer pursuant to section 235-110.9, Hawaii Revised Statues (HRS), is eligible for the motion picture, digital media, and film production income tax credit.

In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for qualified production costs incurred by the entity for the taxable year after June 30, 2006, and before January 1, 2016. The qualified production costs which the tax credit is computed is determined at the entity level. Each partner, S corporation shareholder, or beneficiary of an estate or trust shall separately take into account for its taxable year with or within which the entity's taxable year ends, the partner's, shareholder's, or beneficiary's share of the qualified production costs and the resulting tax credit. A partner's share of the qualified production costs shall be determined in accordance with the ratio in which the partners divide the general profits of the partnership. The qualified production costs of the partnership which are subject to a special allocation that is recognized under IRC section 704(a) and (b) shall be recognized for the purposes of this tax credit. Each S corporation shareholder's qualified production costs is the shareholder's allocated share of the S corporation's qualified production costs. A beneficiary's share of the qualified production costs is allocated between the entity and the beneficiaries based on the income of the entity allocable to each beneficiary. The term "beneficiary" includes an heir, legatee, or devisee.

If a taxpayer is a member of a pass-through entity (i.e., partnership, S corporation, estate, or trust) and the taxpayer claims a tax credit for the entity's qualified production costs, the taxpayer shall attach a copy of the applicable Schedule K-1 to Form N-340 when the tax credit is claimed.

Tax credit to be deducted from income tax liability, if any; refunds. If the tax credit exceeds the taxpayer's income tax liability, the excess of the tax credit over the liability shall be refunded to the taxpayer; provided that no refunds or payment on account of the tax credit shall be made for amounts less than $1.

Time for filing. All claims, including any amended claims, for a tax credit shall be filed on or before the end of the 12th month following the close of the taxable year for which the tax credit may be claimed. An extension of time for filing a return does not extend the time for claiming the tax credit. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the tax credit.

Qualification for the credit. To qualify for the credit, a production must:

1. Meet the definition of a qualified production (see below);
2. Have qualified production costs of at least $200,000;
3. Provide the State, at a minimum, a shared-card, end-title screen credit, where applicable;
4. Provide evidence of reasonable efforts to hire local talent and crew; and
5. Provide evidence of financial or in-kind contributions or educational or workforce development efforts, in partnership with related local industry labor organizations, educational institutions, or both, toward the furtherance of the local film and television and digital media industries.

Definitions. For purposes of the motion picture, digital media, film production income tax credit:

"Commercial" (1) means an advertising message that is filmed using film, videotape, or digital media, for dissemination via television broadcast or theatrical distribution, (2) includes a series of advertising messages if all parts are produced at the same time over the course of six consecutive weeks, and (3) does not include an advertising message with Internet-only distribution.

"Digital media" means production methods and platforms directly related to the creation of cinematic imagery and content, specifically using digital means, including but not limited to digital cameras, digital sound equipment, and computers, to be delivered via film, videotape, interactive game platform, or other digital distribution media (excluding Internet-only distribution).

"Post production" means production activities and services conducted after principal photography is completed, including but not limited to editing, film and video transfers, duplication, transcoding, dubbing, subtitling, credits, closed captioning, audio production, special effects (visual and sound), graphics, and animation.

"Production" means a series of activities that are directly related to the creation of visual and cinematic imagery to be delivered via film, videotape, or digital media and to be sold, distributed, or displayed as entertainment or advertisement of products for mass public consumption, including but not limited to scripting, casting, set design and construction, transportation, videography, photography, sound recording, interactive game design, and post production.

"Qualified production" (1) means a production, with expenditures in the State, for the total or partial production of a feature-length motion picture, short film, made-for-television movie, commercial, music video, interactive game, television series pilot, single season (up to 22 episodes) of a television series regularly filmed in the State (if the number of episodes per single season exceeds 22, additional episodes for the same season shall constitute a separate qualified production), television special, single television episode that is not part of a television series regularly filmed or based in the State, national magazine show, or national talk show, and (2) does not include: daily news, public affairs programs, non-national magazine or talk shows, televised sporting events or activities, productions that solicit funds, productions produced primarily for industrial, corporate, institutional, or other private purposes, and productions that include any material or performance prohibited by chapter 712, HRS.

"Qualified production costs" means the costs incurred by a qualified production within the State that are subject to the general excise tax under chapter 237, HRS, or income tax under chapter 235, HRS, and that have not been financed by any investments for which a credit was or will be claimed pursuant to section 235-110.9, HRS. Qualified production costs include but are not limited to:

1. Costs incurred during preproduction such as location scouting and related services;
2. Costs of set construction and operations, purchases or rentals of wardrobe, props, accessories, food, office supplies, transportation, equipment, and related services;
3. Wages or salaries of cast, crew, and musicians;
4. Costs of photography, sound synchronization, lighting, and related services;
5. Costs of editing, visual effects, music, other post-production, and related services;
6. Rentals and fees for use of local facilities and locations;
7. Rentals of vehicles and lodging for cast and crew;
8. Airfare for flights to or from Hawaii, and interisland flights;
9. Insurance and bonding;
10. Shipping of equipment and supplies to or from Hawaii, and interisland shipments; and
11. Other direct production costs specified by the department in consultation with DBEDT.

Refer to Tax Information Release (TIR) No. 2006-02 and Department of Taxation Announcement No. 2006-05 for more information. Copies of TIR No. 2006-02, Announcement No. 2006-05, and tax forms are available on the Department of Taxation's website at: **www.hawaii.gov/tax**

INFORMATION REPORTING REQUIREMENTS FOR THE TAXPAYER CLAIMING THE CREDIT

A taxpayer must prequalify the production for the credit by registering with the Department of Business, Economic Development, and Tourism (DBEDT) during the development or preproduction stage. Failure to comply with this provision can result in a waiver of the right to claim the credit.

Every taxpayer claiming the credit must, no later than 90 days following the end of each taxable year in which qualified production costs are expended, submit a written, sworn statement to DBEDT identifying:

1. All qualified production costs, if any, in the previous taxable year;
2. The amount of motion picture, digital media, film production income tax credits claimed, if any, in the previous taxable year; and
3. The number of total hires versus the number of local hires by category (i.e., department) and by county.

DBEDT'S DUTIES WITH REGARD TO THE CREDIT

DBEDT shall:

1. Maintain records of the names of the taxpayers and qualified productions thereof claiming the motion picture, digital media, and film production income tax credits;
2. Obtain and total the aggregate amounts of all qualified production costs per qualified production and per qualified production per taxable year; and
3. Provide a letter to the Director of Taxation specifying the amount of the tax credit per qualified production for each taxable year that a tax credit is claimed and the cumulative amount of the tax credit for all years claimed.

Upon each determination, DBEDT will issue a letter to the taxpayer, regarding the qualified production, specifying the qualified production costs, and the tax credit amount qualified for in each taxable year a tax credit is claimed. The taxpayer for each qualified production shall file the letter with the taxpayer's tax return for the qualified production to the Department of Taxation.

Notwithstanding the authority of DBEDT, the Director of Taxation may audit the tax credit amount to conform to the information filed by the taxpayer.

SPECIFIC INSTRUCTIONS

Note for Form N-35, N-20, and N-40 filers:
The qualified production costs which the tax credit is computed is determined at the entity level. Depending on the qualified production costs incurred by the S corporation or partnership, stop at lines 5 and/or 12. Enter the qualified production costs on the applicable Schedule K, Form N-35 or Schedule K, Form N-20. Enter each shareholder or partner's share of the qualified production costs on the appropriate line of Schedule K-1, Form N-35 or Schedule K-1, Form N-20.

For Form N-40 filers, depending on the qualified production costs incurred by the estate or trust, enter the allocable qualified production costs to the estate or trust on lines 5 and/or 12. Enter the distributive share of the qualified produc-

tion costs to each beneficiary on Schedule K-1, Form N-40, line 10.

Line 1 — Enter the total of qualified production costs incurred in the taxable year after June 30, 2006, qualifying for a **15%** credit.

Line 2 — Deduct the qualified production costs on line 1 for which a deduction was taken under IRC section 179 or that have been financed by investments for which a credit was claimed by any taxpayer pursuant to section 235-110.9, HRS.

Line 4 — Flow through of qualified production costs qualifying for a **15%** credit received from other entities, if any. In the case of a taxpayer who is a member of a pass-through entity (i.e., S corporation, partnership, estate, or trust) and the taxpayer claims a tax credit for the entity's qualified production costs qualifying for the 15% credit, enter the amount of the qualified production costs received from the entity on line 4.

Line 5 — See *Note for N-35, N-20, and N-40 filers* above. Estates and trusts: The total qualified production costs qualifying for a **15%** credit on line 5 is to be allocated between the estate or trust and the beneficiaries in the proportion of the income allocable to each party. On the dotted line to the left of line 5, enter the qualified production costs allocable to the estate or trust with the designation "N-40 PORTION." Attach Form N-340 to the N-40 return and show the distributive share of the qualified production costs for each beneficiary.

Form N-35 filers, enter the amount on line 5 on Schedule K, line 12g. Form N-20 filers, enter the amount on line 5 on Schedule K, line 17c. Form N-40 filers enter the distributive share amount on line 10 of Schedule K-1, Form N-40, for each beneficiary.

Line 8 — Enter the total of qualified production costs incurred in the taxable year after June 30, 2006, qualifying for a **20%** credit.

Line 9 — Deduct the qualified production costs on line 8 for which a deduction was taken under IRC section 179 or that have been financed by investments for which a credit was claimed by any taxpayer pursuant to section 235-110.9, HRS.

Line 11 — Flow through of qualified production costs qualifying for a **20%** credit received from other entities, if any. In the case of a taxpayer who is a member of a pass-through entity (i.e., S corporation, partnership, estate, or trust) and the taxpayer claims a tax credit for the entity's qualified production costs qualifying for a **20%** credit, enter the amount of the qualified production costs received from the entity on line 11.

Line 12 — See *Note for N-35, N-20, and N-40 filers* on page 1. Estates and trusts: The total qualified production costs qualifying for a **20%** credit on line 12 is to be allocated between the estate or trust and the beneficiaries in the proportion of the income allocable to each party. On the dotted line to the left of line 12, enter the qualified production costs allocable to the estate or trust with the designation "N-40 PORTION." Attach Form N-340 to the N-40 return and show the distributive share of the costs for each beneficiary.

Form N-35 filers, enter the amount on line 12 on Schedule K, line 12g. Form N-20 filers, enter the amount on line 12 on Schedule K, line 12c. Form N-40 filers enter the distributive share amount on line 10 of Schedule K-1, Form N-40, for each beneficiary.

Line 15 — Enter the total motion picture, digital media, and film production income tax credit claimed for the year on this line and on Schedule CR, line 24 or enter the estate's or trust's share on Form N-40, Schedule F, line 3. For individual taxpayers, round the amount on line 15 to the nearest dollar.

If the tax credit exceeds the taxpayer's income tax liability, the excess of the tax credit over the liability shall be refunded to the taxpayer; provided that no refunds or payment on account of the tax credit shall be made for amounts less than $1.